

# HOUSE BILL REPORT

## HB 2580

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**As Passed House:**  
February 11, 2006

**Title:** An act relating to the excise taxation of persons that inspect, test, and label canned salmon.

**Brief Description:** Providing excise tax relief for persons that process canned salmon.

**Sponsors:** By Representatives Upthegrove, Schual-Berke, P. Sullivan, Simpson and McCune.

**Brief History:**

**Committee Activity:**

Finance: 1/24/06, 1/27/06 [DP].

**Floor Activity:**

Passed House: 2/11/06, 95-1.

**Brief Summary of Bill**

- Creates a new classification under the Business and Occupation tax with a rate of 0.484 percent for persons that inspect, test, and label canned salmon owned by another person.
- Exempts businesses under the new classification from paying retail sales and use taxes on materials used in the labeling or packaging of canned salmon.

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**HOUSE COMMITTEE ON FINANCE**

**Majority Report:** Do pass. Signed by 10 members: Representatives McIntire, Chair; Hunter, Vice Chair; Orcutt, Ranking Minority Member; Roach, Assistant Ranking Minority Member; Ahern, Condotta, Conway, Ericks, Hasegawa and Santos.

**Staff:** Mark Matteson (786-7145).

**Background:**

*Retail sales and use tax and business and occupation tax.* The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail. The use tax applies if retail sales tax has not been collected. Both the state and local governments impose sales and use taxes; the state rate is 6.5 percent and the average local rate is 2 percent statewide. Sales taxes are collected by the seller from the buyer at the time of sale. Use tax is remitted directly to the Department of Revenue (Department). State revenues are deposited to the State General Fund.

The Business and Occupation (B&O) tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. A business may have more than one B&O tax rate, depending on the types of activities conducted. For example, the rate for persons that conduct warehousing, manufacturing, or processing for hire activities is 0.484 percent. The rate for persons that provide services, in general, is 1.5 percent.

*Taxability of manufacturers and processors for hire.* One of the classifications under the B&O tax is for manufacturing activity. Persons are considered manufacturers if the person owns or has title to the item or product that is being manufactured. Persons are considered processors for hire if the person does not own the item or product that is being manufactured but rather performs the manufacturing activity on behalf of the owner. Manufacturing and processing for hire are treated similarly in many instances under state tax law.

Persons who engage in manufacturing or processing for hire are eligible for several tax preferences under the B&O and retail sales and use taxes. Sales to these persons of property that becomes part of the manufactured item are considered sales for resale, since the final manufactured product is presumed to be produced for sale, and so are not subject to retail sales and use tax. In addition, packaging materials that are sold to these persons are also considered sales for resale and so retail sales and use taxes do not apply. In 1995, manufacturers and processors for hire were provided an exemption from retail sales and use taxes on the purchase or acquisition of machinery and equipment (M&E) that is used directly in the manufacturing or processing process. The exemption is also available to persons who perform testing on products for others who are manufacturers or processors for hire.

An important distinction in the taxability of manufacturers and processors for hire is the tax base treatment under the B&O tax. Manufacturing activity is taxed based on the value of the product manufactured, whereas the processing for hire activity is based on the gross receipts of the person conducting the activity. In addition, if the owner of the product that is being processed by a processor for hire maintains a physical presence in the state, the owner is subject to the B&O tax on the value of the finished product, but if the owner has no physical presence, no tax is owed.

*Salmon labeling industry.* Several firms are located in Washington that store, inspect, test, and label canned salmon that was canned outside of Washington. These firms store in warehouses the canned salmon, owned by the out-of-state salmon-canning companies. When receiving appropriate instructions from the owner, the labeler will select a particular batch and inspect, weigh, and vacuum test the cans. The labeler will then label all cans that have passed inspection and package the cans in boxes to be shipped to customers of the salmon-canning companies.

In September 2005, the Department issued an Excise Tax Advisory (ETA) concerning firms that store, inspect, test, and label canned salmon owned by others. The ETA provides that the activity of inspecting, testing, and labeling of canned salmon falls under the general service classification of the B&O tax and so is subject to a 1.5 percent rate; the storage of the cans is subject to the warehousing rate of 0.484 percent. Before the issuance of the ETA, at least two

taxpayers had been reporting the activities other than warehousing under the processing for hire classification at a 0.484 percent rate. The ETA also clarified that the firms conducting the testing activities were eligible for the M&E exemption from sales and use taxes on machinery and equipment used directly to inspect and test the cans. Finally, the ETA provided that retail sales and use taxes were due on sales of labels and packaging materials to the labelers.

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**Summary of Bill:**

Persons who inspect, test, and label canned salmon owned by others are subject to B&O tax at a 0.484 percent rate. Such persons are also exempt from paying retail sales and use taxes on materials used to label canned salmon and on materials used to package canned salmon.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect July 1, 2006, except section 2 which takes effect if section 1 expires under chapter 149, Laws of 2003..

**Testimony For:** This is about continuing a historical tax status, not about a tax loophole. All three of the businesses affected are located in Kent Valley. The DOR's excise tax advisory will cause their taxes to go up. The companies have not done anything to change their taxable status. The role that they play in South King County is an important one.

Salmon Terminals has been in operation since 1918 and is an important part of the regional economy. We have a \$1.7 million payroll with a blue collar, diverse workforce. Our in-state industry competes directly with people overseas that can and label farmed salmon. What you see being sold in Costco today is farmed salmon that was packaged in Chile. Several years ago, it would have been our product.

In September of last year, the Department changed our tax rate. We are not doing anything differently than we did before. In fact, a Department audit in the early 1990s did not raise this issue. We're simply requesting a restoration of the taxable status that we reported under for decades.

I represent the folks that harvest wild fish. We are dependent on this industry to get the products to the market, and support this legislation. We also have a philosophical concern about the Department raising the tax rate on its own. This should be the Legislature's role.

The Department does not have a position on this bill, although we are concerned that the proposed exemption of packaging materials will create a unique exception that other industries will try to exploit.

The Department attempts to earnestly and faithfully interpret and implement the tax laws of the state. When we review activity during an audit, the Department brings to bear its

interpretation of the law, which may change occasionally as laws and rules are examined and reexamined by the executive and judicial branches in the light of ongoing taxpayer activity. A person's classification may change, either for the better or worse. We are not looking for ways to maximize state revenues, but rather the manner in which the law should be most appropriately and fairly administered.

**Testimony Against:** These are new tax loopholes that would be added to the more than 400 tax loopholes. Service Employees International Union believes that the Legislature should reject any new loophole until two important criteria are met. First, the Legislature must enact accountability and disclosure legislation that would broadly address all loopholes, to ensure any tax loophole is an effective use of taxpayer dollars. Currently, there are no standards for creating jobs, never mind what kind of jobs are being created. There is no disclosure of what companies that receive the benefit of tax loopholes are doing with that money that benefits the public interest. Just as this Legislature and the public passed measures last year concerning the audit and accountability of programs and services, we need the same sort of audits and accountability for tax loopholes. Without this kind of accountability and disclosure, we are irresponsibly throwing tax dollars at corporations, while meanwhile hundreds of thousands of low-income children and families lack health care, nursing homes are going bankrupt, and child care workers live in poverty.

Second, the Legislature should reject any new tax loophole until real progress is made toward tax fairness in this state. The lowest 20 percent of earners, which includes our members, pay 17 percent of their income in state and local taxes, while the wealthiest pay only 3 percent of their income in state and local taxes. While corporate interest after corporate interest sends their lobbyist to Olympia to seek tax loopholes on syrup sales, canned salmon, real estate commissions, or country clubs, our members struggle every day to make ends meet under the most regressive tax system in the nation. The public understands that the working and middle class is paying more than its fair share in taxes and that the wealthy are not. They also know that this endless stream of tax loopholes coming out of Olympia adds to the unfairness that increases to their tax burden.

**Persons Testifying:** (In support) Representative Uptegrove, prime sponsor; Lee Johnson and Jack Snedeker, Salmon Terminals; and Ed Owens, Coalition of Coastal Fisheries

(Opposed) Adam Glickman, Service Employees International Union Local 775.

**Persons Signed In To Testify But Not Testifying:** None.